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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1967

No. 652

GEORGE M. BARD, RALPH A. BOGAN, JR., EDWARD O. BOSHELL, M. M. HARDIN, HERBERT F. KORHOLZ, J. PATRICK LANNAN, HOWARD J. LAUHOFF, A. D. MARTIN, HAROLD G. MASON, J. EARLE MAY, HUGH C. MICHELS, AKSEL NIELSEN, D. W. REEVES, R. C. SCHENK, FRANKLIN B. SCHMICK, HAROLD C. STUART, ALBERT W. THOMSON, ARTHUR M. WIRTZ and FRANCIS C. WOOLARD, *Petitioners,*

v.

WILLIAM DASHO, DASHO-ROGERS, INC., an Illinois corporation, and MAURICE H. SCHY, *Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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WILLIAM DASHO, DASHO-ROGERS, INC., an Illinois corporation, and MAURICE H. SCHY, *Respondents*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Petitioners, George M. Bard, Ralph A. Bogan, Jr., Edward O. Boshell, M. M. Hardin, Herbert F. Korholz, J. Patrick Lannan, Howard J. Lauhoff, A. D. Martin, Harold G. Mason, J. Earle May, Hugh C. Michels, Aksel Nielsen, D. W. Reeves, R. C. Schenk, Franklin B. Schmick, Harold C. Stuart, Albert W. Thomson, Arthur M. Wirtz and Francis C. Woolard, pray that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Seventh Circuit, which reversed a judgment of the United States District Court for the Northern District of Illinois, Eastern Division, dismissing Count I of the amended complaint herein.

Opinions Below

The opinion of the United States Court of Appeals for the Seventh Circuit, which was rendered on June 26, 1967 and is appended hereto as Appendix A, is not yet reported.

Prior opinions of the United States District Court for the Northern District of Illinois, Eastern Division, in earlier stages of this litigation are reported at 267 F. Supp. 508 and 267 F. Supp. 513, and appear in the appendix record on appeal (R. 31, 39).

Jurisdiction

The judgment of the Court of Appeals was entered on June 26, 1967. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Questions Presented

(1) Whether a statutory merger involves a sale by the merged corporation or a purchase by the surviving corporation, within the meaning of Section 17(a) of the Securities Act of 1933 (the "Securities Act") (15 U.S.C. § 77q(a); App. B-1) or Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") (15 U.S.C. § 78j(b); App. B-4) and Rule 10b-5 of the Securities and Exchange Commission (the "Commission") (17 C.F.R. § 240.10b-5 (1967); App. B-5); and, if so, whether the complaint in the derivative action before this Court, which alleges no fraudulent misrepresentation or omission in the proxy statement descriptive of the merger but relies only upon alleged corporate mismanagement and allegedly unfair terms of the merger, states a cause of action under Rule 10b-5 against present and former directors of the surviving corporation.

(2) Whether these plaintiffs, as shareholders of the surviving corporation in a merger, whose share-ownership is unchanged in the merger, are purchasers of securities within the meaning of Section 10(b) of the Exchange Act and Rule 10b-5 of the Commission; and, if so, whether the complaint before this Court, which does not allege any fraudulent misrepresentation or omission in the proxy statement descriptive of the merger but relies upon alleged corporate mismanagement and allegedly unfair terms of the merger,

states a cause of action under Rule 10b-5 against present and former directors of that corporation.

(3) Whether Section 17(a) of the Securities Act, or Section 10(b) of the Exchange Act and Rule 10b-5 of the Commission, enable these plaintiffs, as shareholders of a corporation, to assert a derivative action (a) against certain former allegedly dominant shareholders of the corporation, based on a cash sale by them of shares to a third party at an allegedly excessive price, where after the purchase the nominees of the purchaser by proper corporate action succeed sellers as directors and officers of the corporation, or (b) against such purchaser and the successor directors and officers.

(4) Whether Section 17(a) of the Securities Act, or Section 10(b) of the Exchange Act and Rule 10b-5 of the Commission, enable these plaintiffs, as shareholders of a corporation, to assert a derivative action against the directors and officers of the corporation, based on the sale by the corporation of certain portfolio securities to a shareholder of the corporation on allegedly unfair terms in exchange for shares of the corporation and cash, with no allegation of fraud or deceit in the transaction.

(5) Whether these plaintiffs, as shareholders of a constituent corporation in a merger consummated pursuant to votes of shareholders based upon proxy-soliciting material filed with the Commission in conformity with Section 14(a) of the Exchange Act (15 U.S.C. § 78n(a); App. B-4) and the rules of the Commission thereunder, who seek to challenge the merger under federal securities laws may assert a cause of action based on an alleged violation of Section 17(a) of the Securities Act or Section 10(b) of the Exchange Act.

Statutes and Regulations Involved

The relevant portions of Section 2(3) of the Securities Act, defining the terms "sale" and "sell" (15 U.S.C.

§ 77b(3)), and Section 17(a) of the Securities Act, relating to fraudulent transactions in the sale of securities (15 U.S.C. § 77q(a)), are set forth in the Appendix at p. B-1. The relevant portion of Rule 133 of the Commission, promulgated under Section 19 of the Securities Act (15 U.S.C. § 77s) and further defining "sale" (17 C.F.R. § 230.133 (1967)), is set forth in the Appendix at p. B-3. Sections 3(a)(13) and 3(a)(14) of the Exchange Act, respectively defining the terms "buy" and "purchase" and the terms "sale" and "sell" (15 U.S.C. § 78c(a)(13) and (14)), are set forth in the Appendix at p. B-4. Section 10(b) of the Exchange Act, relating to the employment of any manipulative or deceptive device in the purchase or sale of securities (15 U.S.C. § 78j(b)), is set forth in the Appendix at p. B-4; and Section 14(a) of the Exchange Act, relating to the regulation of the solicitation of proxies by the Commission (15 U.S.C. § 78n(a)), is set forth in the Appendix at p. B-4. Rule 10b-5 of the Commission, promulgated under Section 23(a) of the Exchange Act (15 U.S.C. § 78w(a)), relating to the employment of manipulative and deceptive devices in the purchase or sale of securities (17 C.F.R. § 240.10b-5 (1967)), is set forth in the Appendix at p. B-5; and Rule 14a-9 of the Commission (17 C.F.R. § 240.14a-9 (1967)), promulgated under Section 23(a) of the Exchange Act (15 U.S.C. § 78w(a)), relating to the proxy solicitation subject to regulation under Section 14(a) of that Act, is set forth in the Appendix at p. B-5.

Statement

The causes of action alleged in the two counts of the complaint (R. 5, 20, 22)* are asserted by holders of 1,900 shares of common stock of The Susquehanna Corporation

* As permitted by Rule 21-3, this Petition is accompanied by an appendix record on appeal, together with all the proceedings in the Court of Appeals, duly certified by the Clerk of that Court. The appendix record

("Susquehanna"), a Delaware corporation. The complaint states that the actions are brought on behalf of Susquehanna and also for the plaintiffs and other shareholders of Susquehanna similarly situated, and seeks injunctive relief and damages. Count I of the complaint alleges that, pursuant to a conspiracy of certain of the individual petitioner-defendants (which the District Court found to be unsupported by any factual allegations), such defendants who at various times were officers or directors of Susquehanna, caused certain transactions to be effected in violation of Section 17(a) of the Securities Act (15 U.S.C. § 17q(a)) and Section 10(b) of the Exchange Act (15 U.S.C. § 78j(b)) and Rule 10b-5 promulgated by the Commission under the Exchange Act (17 C.F.R. § 240.10b-5). Count II, which was added as a third amendment of the complaint, alleged that certain of the individual defendants, in furtherance of the conspiracy, caused Susequehanna to disseminate a false proxy statement in violation of Section 14(a) of the Exchange Act (15 U.S.C. § 78n(a)) and Rule 14a-9 of the Commission promulgated thereunder (17 C.F.R. § 240.14a-9 (1967).

The defendants' motion to dismiss Count I of the complaint was granted by order of the District Court (entered June 30, 1966) for lack of federal jurisdiction and failure to state a claim upon which relief could be granted (R. 53); and the Court of Appeals reversed this order of the District Court. However, the District Court, by Paragraph 5 of an order entered April 27, 1966 (R. 42), deferred any ruling on the defendants' motion to dismiss Count II. Ac-

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on appeal will be referred to in this petition as "R.", and the proceedings in the Court of Appeals as "Proceedings". The Proceedings include a Joint Proxy Statement of The Susquehanna Corporation and American Gypsum Company, dated November 12, 1965, filed as an Exhibit before the District Court and referred to in the Opinions of the District Court. (R. 36, 38, 52-53).

cordingly, the merits of Count II were not before the Court of Appeals, and its merits are not involved in this Petition. Hence, unless otherwise indicated, Count I of the complaint is in this Petition referred to as "the complaint".

In the early part of 1965 Susquehanna was engaged directly, or through subsidiaries, in various mining and other related activities. Its current assets amounted to approximately $13,500,000 in book value. At that time there were outstanding 2,763,035 shares of Susquehanna's Common Stock, which were held by about 8,750 shareholders. The complaint alleges that 13 of the 19 individual defendants, described in the complaint as the "Lannan group", who in April 1965 controlled in the aggregate 436,297 Susquehanna shares and were officers and/or directors of Susquehanna, were its "dominant shareholders".

The transactions on which the complaint is based were the following:

1. In March and April 1965, defendant Lannan, Chairman of the Board of Susquehanna, solicited proxies from Susquehanna shareholders for the annual meeting of the Corporation to be held on April 19, 1965, under which the shares represented by such proxies would be voted for the election of the Lannan group of defendants and of Messrs. W. H. Hoadley and William J. O'Brien. Susquehanna's stock was traded only "over-the-counter". Hence its proxy-soliciting material was not subject to federal regulation, since the regulations promulgated by the Commission under Section 14(a) of the Exchange Act, as amended in 1964, had not yet become applicable to unlisted companies. The complaint alleges that such proxy-soliciting material falsely represented that merger negotiations were in progress with several major corporations whose stocks were listed on the New York Stock Exchange, and urged the election of the

directors proposed by the management so as not to jeopardize such negotiations.

The members of the Lannan group were elected as directors of Susquehanna at the annual meeting. At that meeting two other defendants, Messrs. A. D. Martin and Albert W. Thomson, were also elected, under cumulative voting, by a group (the "Kansas City group") representing approximately 320,000 shares of stock of Susquehanna.

2. The complaint alleges that on or about May 19, 1965, the members of the Lannan group sold 435,000 shares of Susquehanna stock to defendant Korholz, who purchased such shares in behalf of American Gypsum Company ("Gypsum") for a cash consideration of $6,525,000, alleged to be substantially in excess of the fair market value of such shares. On consummation of the sale of such shares, defendants Korholz, Hardin, Nielsen and Reeves were elected to fill vancancies on the Board and/or Executive Committee of Susquehanna created by the resignation of Lannan and three other directors who were members of the Lannan group. Defendant Korholz owned or controlled 56% of the voting stock of defendant, American Gypsum Company ("Gypsum"), and he and Messrs. Hardin, Nielsen and Reeves were also directors of Gypsum. The complaint alleges that all or a substantial part of the cash required for the purchase of the Susquehanna shares from the Lannan group was obtained through a bank borrowing by or upon the credit of Gypsum.

3. The assets owned by Susquehanna in May, 1965 included 140,000 shares of Common Stock of Vanadium Corporation of America ("Vanadium"). Such shares were thereafter sold by Susquehanna to the "Kansas City group", referred to above, for 222,107 shares of Susquehanna stock, which were owned and controlled by that

group, plus the sum of approximately $3,000,000 paid to Susquehanna in cash. The complaint alleges that the value of the Vanadium stock exceeded by about $700,000 the sum of the cash and the value of the Susquehanna shares received by Susquehanna in exchange, and that the sale was made to prevent the bringing of a stockholders' suit by the Kansas City group against the officers and directors of Susquehanna.

4. At the time of the filing of the first amendment to the complaint, on November 12, 1965 (R. 20), there was about to be submitted to the shareholders of Susquehanna and to the shareholders of Gypsum a Proxy Statement, as filed with the Securities and Exchange Commission under Section 14(a) of the Exchange Act (15 U.S.C. § 78n(a)) and Rule 14a-9 of the Commission (17 C.F.R. § 240.14a-9 (1967)). This Proxy Statement, dated November 12, 1965, which was filed with the Court of Appeals as an Exhibit and is a part of the Proceedings before that Court, solicited the favorable vote of the shareholders of Susquehanna and Gypsum with respect to a proposed merger of Gypsum into Susquehanna, under the terms of which there would be no change in the shareholdings of the Susquehanna shareholders, and shares of Gypsum would be converted into shares of Susquehanna at the rate of one share of Susquehanna stock for each 1.9 shares of Gypsum stock.

* * * *

The complaint, as amended on November 12, 1965, alleged that the individual defendants, as the principal officers and directors of Susquehanna during the period covered by the complaint, were engaged in a conspiracy to defraud Susquehanna, and that the proposed merger was in furtherance of such conspiracy. It therefore, among other things, sought (a) to enjoin the merger, (b) to set aside the sale of the Susquehanna shares to Korholz, or in the alternative to require payment of damages by the Lannan group to

other former stockholders of Susquehanna, and (c) to recover from the individual defendants the amount by which the value of the Vanadium stock was alleged to exceed the consideration received by Susquehanna therefor.

Reasons for Granting the Writ

It is respectfully urged that, for the following reasons, this Court grant the writ sought by this Petition:

1. The Court of Appeals has decided an important basic question of federal law which has not been but should be settled by this Court. Simply stated, the question is whether a statutory merger or consolidation of two corporations, effected in accordance with the provisions of state law pursuant to the requisite vote of the directors and shareholders of the constituent corporations, involves a "sale" of securities under the provisions of the Securities Act, or a "sale" and "purchase" of securities under the provisions of the Exchange Act.

The concurring opinion of a majority of the Court of Appeals, in response to this question, stated: "Legislative history, administrative construction and judicial decision do not produce a clear and consistent answer." (App. A-10).* That opinion refers to the fact that the Federal Trade Commission, which at first administered the Securities Act, required a registration statement before a proposal for merger was submitted to shareholders. It points out, however, that the Securities and Exchange Commission, in 1934, took the position that a merger was not a sale, apparently for any purpose, and hence that under the Securities Act registration was not required.

This position of the Commission, but only with respect to the non-necessity of registration, is reflected in Rule 133,

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* The Court refers to a twenty-page discussion of the subject in Loss, Securities Regulation (1961 ed.) 518-539.

the initial version of which was adopted in 1951 (App. A-11; B-3). Notwithstanding the Rule, the Commission on its own motion filed a brief and supplemental brief before the Court of Appeals in this case, challenging the legal conclusion of the District Court that, since a statutory merger does not involve a "purchase" or "sale" of securities within the meaning of the federal securities laws, the complaint stated no federal cause of action. The Commission clearly regarded the question as of major significance, since it devoted twenty pages to a discussion of the long and tortuous history of the consideration of that question by the courts and the Commission during the thirty years since the original enactment of the federal securities laws. The Commission's brief points out that, although the Commission still deems a consolidation or merger to involve no "sale" of securities for the purpose of the registration requirements of the Securities Act, it does deem a "sale" to be involved for the purpose of determining civil liability under Section 12(2), and civil or criminal liability under Section 17(a), of that Act. This is an artificial distinction, for which there is no basis whatsoever in the Act itself.

The question as to whether a statutory merger involves a "sale" and "purchase" of securities, as it relates to the interpretation and application of the Exchange Act, has been considered by the Commission and the courts only in more recent years. Such consideration has resulted from the development by the courts of the doctrine that violation of Section 10(b) of the Exchange Act (App. B-4) and Rule 10b-5 of the Commission (App. B-5), prohibiting fraudulent practices in the purchase or sale of securities, gives rise to civil liability, even though the Act itself contains no provisions to that effect. Here also the Commission has taken the view, expressed in its brief in the Court of Ap-

peals, that for the purpose of the Exchange Act a statutory merger or consolidation involves a sale and purchase of securities.

In its consideration of the complaint, the District Court was persuaded, by the logic of the position taken by the Court of Appeals for the Ninth Circuit in *National Supply Co.* v. *Leland Stanford, Jr. University,* 134 F. 2d 689 (9th Cir., 1943), cert. den. 320 U.S. 773 (1943), to the effect that a statutory consolidation does not involve a sale for any purpose under the Securities Act. The legal conclusion of the Court in that case was entirely supported by the following views, then expressed to that Court by the Commission in its *amicus curiae* brief:

> "The fact that the change occurs by action of the legal entity—the corporation—not by consent, emphasizes the fact that the type of transaction under consideration lacks prime elements of every contract, and hence, of any 'sale' as defined in the Act—offer and acceptance. * * *
>
> "As applied to statutory consolidations or mergers, the new securities to be issued are not 'sold' to the stockholders, because the requisite vote of stockholders binds all stockholders whether or not as individuals they elect to accept or reject them."

The concurring opinion in the Court of Appeals below cites the *National Supply Co.* case and also refers (App. A-11, 12) to the numerous cases in which there has been before the courts, in the context of a variety of transactions, the basic question as to whether a statutory merger or consolidation involves a "sale" or "purchase" under the federal securities laws. This question is obviously of major

significance in the interpretation and application of those laws, and should be clarified by a decision of this Court.

2. A further reason for the granting of this petition by the Court is that, as the Court of Appeals recognizes in the concurring opinion, its adoption of the "no-sale" theory expressed by the Commission with respect to corporate mergers is in conflict with the decision of the Court of Appeals for the Ninth Circuit in the *National Supply Co.* case, *supra*, stating that "judicial decisions have not been entirely consistent in this field".* The concurring opinion of the Court (App. A-11, 12) summarizes relevant conflicting decisions of the federal courts, and refers to a recent decision of the Court of Appeals for the Second Circuit, as to which a petition for certiorari is pending in this Court. *Vine* v. *Beneficial Finance Company*, 374 F.2d 627, 635 (2d Cir. 1967). That decision holds that a shareholder who is given the right, in a short-form merger, to turn in his shares for cash, and who has the statutory alternative of seeking an appraisal, is a "purchaser" of shares, for the purpose of the Exchange Act and Rule 10b-5 of the Commission, even though no action by him was necessary or was sought.

3. The "no-sale" theory as to a statutory merger, for purposes of the Securities Act and the Exchange Act, is particularly applicable in the case at bar, since although the plaintiffs, as shareholders of Susquehanna, were entitled to vote with respect to the merger, that corporation continued in existence, and there was no change in the identity or number of shares held by its shareholders. Only the shareholders of Gypsum received new shares of Susquehanna. So far as the shareholders of Susquehanna were concerned, the situation was no different than would have been the case if Susquehanna had issued its stock to a third party for the

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* A recent decision, which was not cited by the Court of Appeals, in which it was held that a statutory merger did not involve a sale of securities, is *Cohne* v. *Salisbury*, Unreported (D. Utah) No. C-170-65 (July 6, 1966).

purpose of acquiring the assets from that third party. Certainly in such event no one would urge that there had been an issue or sale of stock by Susquehanna to its existing shareholders or a purchase of such stock by them. In this respect, the merger transaction, even more clearly than that in *Vine* v. *Beneficial Finance Corporation, supra,* involves no sale to or purchase of securities by the plaintiffs.

It appears that plaintiffs do not seriously challenge this conclusion. In any event, their action, although purportedly a representative action on behalf of themselves and other Susquehanna shareholders, is also a derivative action in behalf of Susquehanna. And the Court of Appeals, although erroneously referring to the merger as a transaction in which "the owner of [Susquehanna] stock had in effect purchased a new security and paid for it by turning in his old one" (App. A-7), concluded that it was Susquehanna which was entitled to assert the cause of action.

In essence, this conclusion is based on the premise that a combination of the assets of the constituent corporations in a statutory merger or consolidation involves a purchase and sale of corporate assets within the meaning of the federal securities laws. However, this question was not specifically considered by the Court of Appeals, and, insofar as we are aware, has not heretofore been specifically considered by the Commission or the courts. This new aspect of the general question as to the status of corporate mergers is of fundamental importance in the interpretation and application of the federal securities laws. If every statutory merger or consolidation involves a sale to and a purchase by the surviving corporation of the assets of the other constituent corporations, then in any case in which securities are included in the assets of a constituent corporation (regardless of whether they are securities issued by one of the constituent corporations or are other securities), the terms of the transaction may be subject to examination by

a federal court under Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act. All that is needed, assuming the requisite use of the mails or interstate commerce, is an allegation by a stockholder of one of the constituent corporations that the terms of the merger are so unfair as to be fraudulent with respect to any of the corporations involved, without reference to the adequacy of the factual disclosures made in the proxy statement furnished to the shareholders of the constituent corporations.

4. There is at least one other respect in which the decision of the Court of Appeals involves an important interpretation and application of federal law, and is at variance with the decisions of other federal courts. One of the underlying transactions relied on by the plaintiffs, as part of the alleged "fraudulent conspiracy", was the sale by certain of the defendants to Korholz, in behalf of Gypsum, seven months prior to the merger, of their shares of Susquehanna for a cash consideration alleged to be excessive. This was a transaction to which neither Susquehanna nor the plaintiffs were parties. It was entirely between certain of the defendants, who were selling their Susquehanna shares, and a corporation which subsequently became the non-surviving corporation in the merger with Susquehanna. However, other federal courts have held that Rule 10b-5 of the Commission merely extends the prohibitions of Section 17 (a) of the Securities Act against the *sellers* of securities, so as to make such prohibitions applicable to the *purchasers* as well as the sellers of securities. The Court of Appeals for the Second Circuit in 1952 stated its conclusion to be "that that section [Section 10(b) of the Exchange Act] was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and that Rule X-10B-5 [now Rule 10b-5]

extended protection only to the defrauded purchaser or seller." *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461, 464 (2d Cir. 1952), cert. den. 343 U.S. 956 (1952).* This interpretation was recently re-affirmed in *Barnett* v. *Anaconda Company*, 238 F. Supp. 766, 768 (S.D.N.Y. 1965), where the Court states:

> "The questions raised concern the extent to which actions primarily involving minority stockholders' rights under state law may be maintained in the federal courts under the umbrella of the federal Securities Acts. Aspects of these questions have been arising with increasing frequency." (p. 768)
>
> "It is now settled that federal private rights of action may arise in favor of a corporation or its stockholders for violation of § 14(a). *J. I. Case* v. *Borak*, 377 U.S. 426 (1964). Private rights of action have also been recognized for violation of §§ 17(a) and 10(b). [Citations] *But this does not mean that the Securities Acts have swallowed the whole body of state statutory and common law covering the internal administration of the affairs of corporations and the fiduciary obligation of those who manage and control them.* * * *" (p. 770) (Emphasis added.)

A related federal question, which is raised by the decision of the Court of Appeals and is suggested by the last quoted passage and the *J. I. Case* decision, is whether, even if Section 10(b) and Rule 10b-5 might, under some circumstances, provide the basis for the assertion of a private cause of action, a private claim may be based on an alleged violation of that Rule where, as here, the complaint which was before

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* To the same effect is *Elfenbein* v. *Yaeger*, '61-'64 CCH Fed. Sec. L. R. 94,548 (S.D.N.Y., 1964). In his treatise on securities regulation, Professor Loss expresses the opinion that the Court's view in the *Birnbaum* Case seems "basically correct". 3 Loss, Securities Regulation 1469 (2d ed. 1961).

the Court of Appeals made no allegation of any fraudulent misrepresentation or omission in the Proxy Statement relating to the merger, as filed with the Commission under Section 14(a) of the Exchange Act and circulated to the stockholders of Susquehanna and Gypsum.

• • • •

In substance, the complaint which was before the Court of Appeals was either seeking redress on the ground of alleged corporate mismanagement, or was challenging the fairness of the Gypsum-Susquehanna merger. Neither claim of itself is properly subject to the jurisdiction of a federal court. To support such jurisdiction, it is essential that there be a showing of violation of Section 17(a) of the Securities Act or of Section 10(b) of the Exchange Act and the Commission's related Rule 10b-5. We respectfully urge that the importance to the public and to the business and financial community of a proper interpretation and application of these basic provisions of federal law warrants the consideration by the Court of the questions presented in this case.

Conclusion

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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September 25, 1967

APPENDIX A

Opinion Below

IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 15839 SEPTEMBER TERM, 1966 APRIL SESSION, 1967

WILLIAM DASHO, DASHO-ROGERS, INC., an Illinois corporation, and MAURICE H. SCHY, *Plaintiffs-Appellants,*

v.

THE SUSQUEHANNA CORPORATION, a Delaware corporation, George M. Bard, Ralph A. L. Bogan, Jr., Edward O. Boshell, M. M. Hardin, Herbert F. Korholz, J. Patrick Lannan, Howard J. Lauhoff, A. D. Martin, Harold G. Mason, J. Earle May, Hugh C. Michels, Aksel Nielsen, D. W. Reeves, R. C. Schenk, Franklin B. Schmick, Harold C. Stuart, Albert W. Thomson, Arthur M. Wirtz, Francis C. Woolard and American Gypsum Co., a New Mexico corporation, *Defendants-Appellees.*

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division

JUNE 26, 1967

Before SCHNACKENBERG, FAIRCHILD and CUMMINGS, *Circuit Judges.*

SCHNACKENBERG, *Circuit Judge.* William Dasho, Dasho-Rogers, Inc., an Illinois corporation, and Maurice H. Schy, plaintiffs, have appealed from an order of the district court entered June 30, 1966, dismissing a derivative action brought by plaintiffs, as shareholders of The Susquehanna Corporation, against (*inter alia*) its officers and directors, charging a conspiracy to defraud Susquehanna in the sale and pur-

chase of securities in violation of § 17 (a) of the Securities Act of 1933, 15 U.S.C.A. § 77q, § 10 (b) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78j, and of rule 10b-5 of the Rules of the Securities and Exchange Commission ("SEC").

On December 21, 1965, plaintiffs had filed a third amendment to the complaint adding count II, in which they alleged *inter alia* that defendants caused Susquehanna to distribute a false proxy statement on or about November 12, 1965, violative of § 14 (a) of the 1934 Act, which led to stockholder approval of Susquehanna's merger with defendant American Gypsum Company, a New Mexico corporation.

Although not so designated on its face, the complaint filed October 22, 1965 was referred to by the district court and by the parties as count I, and is so referred to in this opinion.

Defendants moved to dismiss both counts. Although there was no ruling as to count II, which is not a part of this appeal, the district court sustained defendants' motions to dismiss count I, and, in so doing, made reference to a proxy statement attached as an exhibit to count II.

From the sworn complaint, as amended, these facts appear: Susquehanna on June 30, 1965 had outstanding 2,763,035 shares of stock, traded in the over-the-counter market. It had about 8,755 shareholders. Its principal assets were cash, short-term investments, and the ownership of subsidiary companies engaged in activities such as mining and processing of ores, operation of a bus line, production of sulphuric acid, vanadium pentoxide and an aggregate used in the manufacture of concrete. Its current assets at the end of its fiscal year on June 30, 1965, amounted to $13,730,081, which was about 15 times its current liabilities of $917,331. It also had an income tax carry forward credit of about $12,000,000, acquired in connection with the liquidation of a railroad.

During the year before April 19, 1965, Susquehanna was managed by defendants George M. Bard, Ralph A. L. Bogan, Jr., Edward O. Boshell, J. Patrick Lannan, Howard J. Lauhoff, Harold G. Mason, J. Earle May, Hugh C. Michels, R. C. Schenk, Franklin B. Schmick, Harold C. Stuart, Arthur M. Wirtz, and Francis C. Woolard, here referred to as "the Lannan group", who individually owned or controlled 436,-

297 shares on that date. They were directors or officers, the dominant shareholders being Lannan, chairman of the board, and Schenk, president and director.

(a) It further appears from said complaint, upon information and belief, that the Lannan group, in complete disregard and in derogation of their duty to Susquehanna and to its other shareholders, and intending unjustly to enrich themselves at the expense and to the damage of Susquehanna and its other shareholders, agreed and conspired among themselves, and with defendant Herbert F. Korholz, acting for himself and Gypsum, to cheat and defraud Susquehanna and said other shareholders out of property and property rights having great value. This was to be done by causing Susquehanna to acquire by indirection 435,000 shares of its own stock, all or a substantial part of which were owned or controlled by the Lannan group, at a price about $1,740,000 in excess of the fair market value of such shares. This result was to be accomplished through the device of a sale of the shares by the group to Gypsum, acting through Korholz, its president and majority stockholder, followed by a merger into Susquehanna. An inducement to Korholz was the transfer of control of Susquehanna, by seriatum resignations of Lannan group directors, and the substitution of Korholz and his nominees. Success of this plan depended upon the re-election of the group as Susquehanna directors at the annual stockholders' meeting on April 19, 1965. To carry out this plan, the group solicited proxies pledging its own re-election to the Susquehanna board. These solicitations contained misrepresentations of fact, in furtherance of the conspiracy, pleaded with particularity in the complaint.[1] With the proxies so obtained, the group elected to

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[1] At the stockholders' meeting on April 19, 1965, where Lannan and Schenk presided, Lannan represented to the stockholders present:

> "• • • that a merger of Susquehanna with one of several companies listed on the New York Stock Exchange was imminent; that such merger would be beneficial to Susquehanna and its shareholders; that such pending merger negotiations would be hampered and have little chance to materialize unless the Lannan group of defendants and the two additional candidates nominated by management were elected as directors of the corporation. Defendant Lannan further represented

the board thirteen of its members. Of the defendants here who were Susquehanna directors, all were present at that meeting, but none did anything to inform the shareholders of the real plan of the Lannan group to merge with Gypsum. A dissident group of shareholders (the "Kansas City Group"), representing about 328,000 shares, cumulated their votes and placed defendants A. D. Martin and Albert W. Thompson on the board.

On May 19, 1965, defendants Lannan and Korholz issued a press release stating that Lannan and "major Susquehanna shareholders" had sold 435,000 shares of Susquehanna which they owned or controlled to Korholz acting on behalf of Gypsum, for $6,525,000 in cash.

The vacancies on the Susquehanna board were filled by electing Korholz as chairman and defendants Hardin, Nielsen and Reeves, as members thereof, they being the nominees of Korholz.

The foregoing transfer of control of the Susquehanna board was averred in count I to be in furtherance of the conspiracy.

(b) Count I alleges that, in furtherance of the conspiracy, in May 1965 the Kansas City group threatened to sue, charging corporate mismanagement, and defendants caused Susquehanna to exchange 140,000 shares of Vanadium Corporation stock owned by Susquehanna for 222,107 shares of Susquehanna owned by the Kansas City group, plus $300,685 in cash. This exchange was on a basis which undervalued the Vanadium stock by $700,000, the profit realized by the Kansas City group two weeks later on a resale of that stock to the Vanadium Corporation.

Korholz owned or controlled 56% of the outstanding voting stock of Gypsum. He secured the passage of resolutions by the directors of the two corporations, recommending merger of Gypsum into Susquehanna, on the ratio of 1.9 shares of Gypsum for 1 share of Susquehanna, a ratio, averred in count I to represent a gross overvaluation of

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to the stockholders present at the meeting that he would not sell his Susquehanna shares for $15 per share, a price then approximately 20% above market, notwithstanding that he had already agreed to sell [those] shares to defendant Korholz at $15 per share. * * *"

the Gypsum stock. Although included in the assets of Gypsum were the 435,000 Susquehanna shares purchased from the Lannan group, Gypsum purchased these shares with funds borrowed from a bank, which loan was in effect assumed by Susquehanna under the merger agreement. Thus, if the merger were consummated, Susquehanna would have acquired 435,000 shares of its own stock at a price of about $1,740,000 in excess of the fair market value thereof.

Plaintiffs in count I sought, *inter alia*, to enjoin the Gypsum-Susquehanna merger, to recover for Susquehanna the $1,740,000 premium realized by the Lannan group on the sale of the 435,000 shares of Susquehanna, and to surcharge defendants with $700,000, the amount by which they undervalued Susquehanna's holding of Vanadium shares, in the exchange of such shares owned by the Kansas City group.

While defendants moved to dismiss count I on the ground that plaintiffs were not purchasers or sellers of securities, plaintiffs point out that they sued derivatively, asserting a cause of action belonging to Susquehanna, the corporation injured by the wrongful acts of its officers and directors, which is the real party-plaintiff.

Plaintiffs contend that, under the facts alleged by them and the decided cases, the "issuance" by a corporation of shares to be exchanged for shares or assets of another corporation constitutes the issuing corporation either a seller or a purchaser of securities entitled to the protection of the securities laws. In addition, it appears from a brief which we permitted to be filed by the Securities and Exchange Commission as amicus curiae, that the question presented here is not whether a purchase or a sale was made by an individual Gypsum or Susquehanna shareholder, but that the issue is whether there was a purchase or a sale by Susquehanna itself. We are impressed by the argument of the Commission that the proposed merger of Gypsum into Susquehanna involved both a purchase (the acquisition by Susquehanna of 435,000 shares of its own stock) and a sale (the issuance of Susquehanna shares to Gypsum's shareholders) by Susquehanna.

Our attention is called to Sections 3 (a) (13) and 3 (a) (14) of the Exchange Act, 15 U.S.C. 78c (a) (13) and 78c

(a) (14), which define the word "purchase" to "include any contract to buy, purchase, or otherwise acquire," and "sale" to "include any contract to sell or otherwise dispose of." This broad language indicates an intention by Congress that the words "purchase" and "sale" are not limited to transactions ordinarily governed by the commercial law of sales. The purpose is evidently to make control of securities transactions reasonably complete and effective to accomplish the purposes of the legislation.

In *Ruckle* v. *Roto American Corporation,* 2 Cir., 339 F.2d 24 (1964), the court said, at 27:

> "As a matter of authority and principle, the issuance by a corporation of its own shares is a 'sale' to which the anti-fraud policy expressed in the federal securities laws extends. Hooper v. Mountain States Securities Corp., 5 Cir., 1960, 282 F. 2d 195, 200-203, cert. denied, 1961, 365 U.S. 814, 81 S.Ct. 695, 5 L.Ed. 2d 693; * * *"

We are of the opinion that an acquisition or disposition of securities in exchange for other securities falls within the statutory definitions and that this reasoning applies to a case of merger. There are no circumstances indicating a contrary congressional intent, but the legislative history and the purpose of the securities laws indicate that an exchange of securities incidental to a merger is subject to their antifraud protections.

Inasmuch as the Exchange Act was meant to enlarge the protection for investors afforded by an earlier act (1933), it seems reasonable to say that Congress intended such reorganizations as that here involved to come within its antifraud provisions.

We reach the conclusion that the Supreme Court never intended to give to the word "sale" the limited common-law meaning of that word, when applied to stock transactions such as those which we consider in the case at bar. As that court said in *Wilko* v. *Swan,* 346 U.S. 427 (1953), at 430-31:

> "In response to a Presidential message urging that there be added to the ancient rule of *caveat emptor* the further doctrine of 'let the seller also beware,' Congress passed the Securities Act of 1933. Designed to protect

> investors, the Act requires issuers, underwriters, and dealers to make full and fair disclosure of the character of securities sold in interstate and foreign commerce and to prevent fraud in their sale. To effectuate this policy, § 12 (2) created a special right to recover for misrepresentation which differs substantially from the common-law action in that the seller is made to assume the burden of proving lack of scienter. * * *"

The Supreme Court in *Securities & Exchange Commission* v. *Howey Co.*, 328 U.S. 293, 299 (1946), recognized that, for the purpose of the Securities Act, the term "investment contract" would be interpreted according to

> "* * * a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."

Thus in the case at bar, when the merger was approved and the exchange of securities occurred, the owner of stock had in effect purchased a new security and paid for it by turning in his old one. In such a situation the antifraud protections afforded by the Securities Act are needed no less than in a situation where one makes an outright purchase of stock for cash. We agree with counsel for the amicus curiae that the complex nature of a merger enhances the opportunities for fraud and thus increases the need for antifraud protection.

We are compelled to the conclusion that the district court was unduly impressed by the semantic and conceptual difficulties arising when the words "purchase" and "sale" are applied to mergers.

We conclude and hold that, for the purpose of this case, there is no inherent distinction under the Securities and Exchange acts between a corporate sale of stock for cash and the relative impact on the corporate shares of two corporations resulting from their merger.

In view of this result, it is not necessary for us to consider other points raised by plaintiffs.[2]

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[2] Lauhoff's contention that count I is insufficient to state a claim for relief against "him in particular" is without merit herein. Lauhoff's sale of his

Wherefore, the order from which this appeal was taken is reversed and this cause is remanded to the district court for further proceedings.

Reversed and remanded.

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stock and his resignation as a director were allegedly two of the overt acts done by him in furtherance of the conspiracy. Thus, having allegedly joined the conspiracy and taken steps to assure its success, Lauhoff is responsible for the acts of his co-conspirators in furtherance of said conspiracy.

FAIRCHILD, *Circuit Judge* (with whom CUMMINGS, *Circuit Judge,* joins), concurring. Two different transactions are presented as foundations for causes of action under the fraudulent interstate transactions section of the securities act [1] and the manipulative and deceptive practices section of the exchange act.[2] And we must answer two questions of law, each of considerable difficulty.

The Transactions:

I. *The transfer, by successive steps, of 435,000 shares of Susquehanna stock from the Lannan defendants to Korholz and Gypsum, and ultimately into the assets of post-merger Susquehanna, via the merger of Gypsum into Susquehanna.* It is claimed that this was a fraudulent scheme by which the Lannan defendants could extract a highly excessive price from Susquehanna for their shares.

II. *The sale by Susquehanna of 140,000 shares of Vanadium stock to the Kansas City group in return for 222,107 shares of Susquehanna stock, plus boot money.* It is claimed that this sale produced a large profit for the Kansas City group and was a scheme devised by defendants in order to silence the Kansas City group and protect the carrying out of Transaction I for the benefit of defendants.

The Questions:

A. *Does a statutory merger involve a sale of securities so that a cause of action in favor of Susquehanna can be predicated upon the alleged fraudulent scheme involved in Transaction II?* It is not claimed that Gypsum had a cause of action which became the property of Susquehanna upon merger, presumably because the Lannan group did not owe Gypsum the special duty as directors which they owed Susquehanna.

B. *When the directors of a corporation cause it to buy securities at an excessive price or to sell securities at an inadequate price, in order to serve some personal interest of the directors, adverse to the corporation, may a cause of action under the securities and exchange acts arise in favor of the corporation by reason of the failure of the directors*

[1] 15 U.S.C. 77q.
[2] 15 U.S.C. 78j.

to fulfill the special obligations they owe the corporation as directors? Causes of action may well arise under state law under these circumstances, but, assuming other grounds required for federal jurisdiction, do activities of corporate directors for their personal advantage at the expense of the corporation amount to fraud under the securities and exchange acts?

A. *Does a statutory merger involve a sale of securities?* This question has usually been considered in terms of whether, upon merger, there is a sale of shares in the post-merger surviving corporation to the shareholders of the merging corporations in exchange for their pre-merger shares in each corporation. If such sale occurs, within the meaning of the securities and the exchange acts, fraud in persuading the shareholders to approve merger would give rise to a federal cause of action in favor of the shareholders. Here, however, one of the merging corporations, which is also the surviving corporation, is asserting a cause of action grounded on the fact that the merger, by design of the defendants, has forced it to assume the obligation for the excessive price at which the other merging corporation purchased an asset. (Or perhaps the merger could be analyzed as a purchase by Susquehanna of Gypsum's assets including the 435,000 shares, accepted at a figure in excess of their value, in return for issuance of Susquehanna shares to Gypsum shareholders.)

Neat corporate theory would dictate that a statutory merger involves no sale of the shares or assets of merging corporations, but in the light of the purpose of the securities and exchange acts to protect the investing public, it seems reasonable that the concept of sale in these acts may encompass the various modifications in rights which are produced by merger.

Legislative history, administrative construction, and judicial decision do not produce a clear and consistent answer.[3]

Professor Loss finds, in a 1933 committee report, an indication that a merger was regarded as a sale for which 15

[3] See, generally, Loss, Securities Regulation (1961 ed.) 518-539.

U.S.C. § 77e would require a registration statement,[4] and the Federal Trade Commission, which at first administered the securities act, required a registration statement before a proposal for merger was submitted to shareholders.

Starting in 1934, however, the Securities and Exchange Commission indicated that a merger was not a sale such that a registration statement is required.[5] This remains the position of the commission, although in 1956, the commission considered repeal of its Rule 133, stating that its construction had "become an instrument of evasion of the law."[6] Prior to 1951 the commission took the even broader position that a merger was not a sale, apparently for any purpose.[7] In 1951, the commission adopted Rule 133, making it clear that its position that a statutory merger involves no sale applies only to the registration requirements of the act. In the case at bar, the commission takes the position that an exchange of shares pursuant to a merger is a sale so that the antifraud sections of the acts apply.

Judicial decisions have not been entirely consistent in this field.

In 1943, the ninth circuit indicated the view that a consolidation did not involve a sale of securities or an exchange amounting to a sale[8] although this was not the principal ground for the decision.

In 1960, a district court held that a merger "may or may not involve a purchase and sale within the meaning of Section 10(b)" of the exchange act, and that the transaction before the court appeared to be a purchase and sale. The type of merger does not appear in the opinion. It was said

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[4] Loss, op. cit. 519, H.R. Rep. No. 85, 73d Cong. 1st Sess. (1933) 16.

[5] Loss, *supra* footnote 3, p. 520; Note to Rule 5 of Form E-1, adopted 1935; Rule 133, adopted 1951.

[6] Loss, *supra* footnote 3, p. 529, n. 232.

[7] In *National Supply Co.* v. *Leland Stanford Jr. University* (9th Cir. 1943), 134 F. 2d 689, 694, *cert. den.* 320 U.S. 773, the court noted that the commission had filed an amicus brief "indicative of its view that the consolidation did not involve a 'sale' of securities, or an exchange amounting to a sale, hence the civil liability provisions of the Act have no application."

[8] *National Supply Co.* v. *Leland Stanford Jr. University, supra* footnote 7. See *Sawyer* v. *Pioneer Mill Company* (9th Cir. 1962), 300 F. 2d 200, where the question would have arisen again, but for mootness.

that "Plaintiff is a corporation which issued its stock in exchange for the stock of another corporation." [9]

In 1963, this circuit considered an attack on a merger where a violation of sec. 10 (b) of the exchange act had been alleged, among other things, but the opinion sets forth no distinct holding that a statutory merger is not a sale under the securities and exchange acts.[10]

In 1966, a district court appears to have held that a merger was a sale so that shareholders had a cause of action on account of misleading reports which persuaded them to vote for the merger.[11]

And in 1967, the second circuit held that a shareholder who was given the right, in a short form merger, to turn in his shares for cash, and who had the statutory alternative of seeking an appraisal, was a seller who might have a cause of action for deceptive practices under the exchange act.[12] A district court reached the same conclusion in 1965.[13]

The argument that the transformation of rights occurring upon statutory merger is a distinct corporate phenomenon which does not involve purchase and sale of securities has some appeal, but in view of the objectives of the securities and the exchange acts, it seems to me better to recognize, for the purpose of the antifraud provisions, that sales and purchases are involved. This view does no violence to the statutory language, and is the present interpretation of the body which is responsible for the administration of the acts.

B. *Misuse of directors' power as fraud.* Deception by defendants is more readily spelled out in Transaction I. The allegations suggest that the sale of 435,000 shares owned by the directors to the corporation at an excessive price was somewhat concealed by a scheme, composed of the successive transfers and the ultimate merger. There

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[9] *H. L. Green Company* v. *Childree* (S.D.N.Y. 1960), 185 F. Supp. 95, 96.

[10] *Borak* v. *J. I. Case Company* (7th Cir. 1963), 317 F. 2d 838, 847, *aff'd*, 377 U.S. 426 (1964).

[11] *Simon* v. *New Haven Board & Carton Company* (D. Conn. 1966), 250 F. Supp. 297, involving a long form merger such as in this case.

[12] *Vine* v. *Beneficial Finance Company* (2d Cir. 1967), 374 F. 2d 627, 635.

[13] *Voege* v. *American Sumatra Tobacco Corporation* (D. Delaware 1965), 241 F. Supp. 369, 373.

may be both palpable deception and failure to disclose defendants' adverse personal interest. With respect to Transaction II, there is only the latter.

In *Birnbaum* v. *Newport Steel Corp.*[14] the second circuit held that where a corporate insider sold his stock to a third party, and misrepresented the facts to the other shareholders, this gave rise to no cause of action under the exchange act in favor of the shareholders. "The district court, however, viewed the Rule in question as aimed only at 'a fraud perpetrated upon the purchaser or seller' of securities and as having no relation to breaches of fiduciary duty by corporate insiders resulting in fraud upon those who were not purchasers or sellers." The court of appeals agreed. The case can be distinguished on its facts from the present one because the corporation is here suing as a defrauded seller and buyer of securities. The second circuit has recently noted the commission's view that the *Birnbaum* rule is too narrow.[15]

In *Ruckle* v. *Roto American Corporation*,[16] the second circuit held "that federal courts have jurisdiction over actions in which the complaint alleges that a corporation has been or may be defrauded into issuing or selling securities through the failure or refusal of some of its directors fully to disclose to the remaining directors material facts concerning the transactions or the financial condition of the corporation." The same holding would follow (under the exchange act) where a corporation, as here, has purchased securities.

In *O'Neill* v. *Maytag*,[17] the second circuit concluded that where all the directors participated in causing the corporation to exchange stock at a disadvantage to it and personal advantage to them, there could be no claim of deceit, withheld information, or misstatement of material fact. The only possible material difference I can perceive between *Ruckle* and *O'Neill* is that in *Ruckle* there were directors

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[14] (2d Cir. 1952), 193 F. 2d 461, 462-3, *cert. den.* 343 U.S. 956 (1952).

[15] *A. T. Brod & Co.* v. *Perlow* (2d Cir. 1967), 375 F. 2d 393, 397, footnote 3.

[16] (2d Cir. 1964), 339 F. 2d 24, 26, *cert. den.* 368 U.S. 448 (1962).

[17] (2d Cir. 1964), 339 F. 2d 764.

who were not participants in the transaction and thus could be deceived in the ordinary sense. In either case, however, the failure of the defendant directors to perform their duty presumably injured the corporation, and I do not believe it is sound to differentiate between situations where the directors were unanimous in wrongdoing and those where less than all were involved.

I conclude that Susquehanna has a cause of action both with respect to the allegedly improvident acquisition, by merger, of 435,000 Susquehanna shares and the allegedly improvident exchange of Vanadium shares for Susquehanna shares.

* * * *

APPENDIX B

Statutes and Regulations Involved

SECURITIES ACT OF 1933:

Definitions:

"Sec. 2. When used in this subchapter, unless the contract otherwise requires—

* * * *

(3) The term "sale" or "sell" shall include every contract of sale or disposition of a security or interest in a security, for value. The term "offer to sell", "offer for sale", or "offer" shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value. * * * *"

* * * *

(15 U.S.C. § 77 b (3)).

Fraudulent Interstate Transactions:

"Sec. 17. (a). It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments or transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission or to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

* * * * *

(15 U.S.C. §77 q (a)).

SECURITIES AND EXCHANGE COMMISSION RULE 133: Definition for Purposes of Section 5 of the Act of "Sale", "Offer", "Offer to Sell", and "Offer for Sale".

"(a) For purposes only of Section 5 of the Act [Securities Act of 1933], no 'sale,' 'offer,' 'offer to sell,' or 'offer for sale' shall be deemed to be involved so far as the stockholders of a corporation are concerned where, pursuant to statutory provisions in the State of incorporation or provisions contained in the certificate of incorporation, there is submitted to the vote of such stockholders a plan or agreement for a statutory merger or consolidation or reclassification of securities, or a proposal for the transfer of assets of such corporation to another person in consideration of the issuance of securities of such other person or voting stock of a corporation which is in control, as defined in Section 368(c) of the Internal Revenue Code of 1954, of such other person, under such circumstances that the vote of a required favorable majority (1) will operate to authorize the proposed transaction so far as concerns the corporation whose stockholders are voting (except for the taking of action by the directors of the corporation involved and for compliance with such statutory provisions as the filing of the plan or agreement with the appropriate State authority, and (2) will bind all stockholders of such corporation except to the extent that dissenting stockholders may be entitled, under statutory provisions contained in the certificate of incorporation, to receive the appraised or fair value of their holdings."

* * * *

17 C.F.R. § 230.133 (1967).

SECURITIES EXCHANGE ACT OF 1934:

Definitions and Application:

"Sec. 3(a) When used in this chapter, unless the context otherwise requires—

* * * *

(13) The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire.

(14) The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

(15 U.S.C. § 78c(a)(13)(14)).

Manipulative and Deceptive Devices:

"Sec. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

(15 U.S.C. § 78j(b)).

Proxies:

"Sec. 14 (a). It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78*l* of this title."

* * * *

(15 U.S.C. § 78n(a)).

SECURITIES AND EXCHANGE COMMISSION RULE 10b-5:

Employment of Manipulative and Deceptive Devices.

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails of any facility of any national securities exchange.

(a) To employ any device, scheme, or artifice to defraud.

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

in connection with the purchase or sale of any security."

(17 C.F.R. § 240.10b-5 (1967)).

SECURITIES AND EXCHANGE COMMISSION RULE 14a-9:

False or Misleading Statements.

"No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

* * * *

(17 C.F.R. § 240.14a-9 (1967))

SUPREME COURT, U. S.

Office Supreme Court, U.S.
FILED
OCT 30 1967
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1967.

No. 652

GEORGE M. BARD, RALPH A. BOGAN, JR., EDWARD O. BOSHELL, M. M. HARDIN, HERBERT F. KORHOLZ, J. PATRICK LANNAN, HOWARD J. LAUHOFF, A. D. MARTIN, HAROLD G. MASON, J. EARLE MAY, HUGH C. MICHELS, AKSEL NIELSEN, D. W. REEVES, R. C. SCHENK, FRANKLIN B. SCHMICK, HAROLD C. STUART, ALBERT W. THOMSON, ARTHUR M. WIRTZ and FRANCIS C. WOOLARD,

Petitioners,

vs.

WILLIAM DASHO, DASHO-ROGERS, INC., an Illinois corporation, and MAURICE H. SCHY,

Respondents.

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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THE GUNTHORP-WARREN PRINTING COMPANY, CHICAGO

IN THE

Supreme Court of the United States

OCTOBER TERM, 1967.

No. 652.

GEORGE M. BARD, RALPH A. BOGAN, JR., EDWARD O. BOSHELL, M. M. HARDIN, HERBERT F. KORHOLZ, J. PATRICK LANNAN, HOWARD J. LAUHOFF, A. D. MARTIN, HAROLD G. MASON, J. EARLE MAY, HUGH C. MICHELS, AKSEL NIELSEN, D. W. REEVES, R. C. SCHENK, FRANKLIN B. SCHMICK, HAROLD C. STUART, ALBERT W. THOMSON, ARTHUR M. WIRTZ and FRANCIS C. WOOLARD,

Petitioners,

vs.

WILLIAM DASHO, DASHO-ROGERS, INC., an Illinois corporation, and MAURICE H. SCHY,

Respondents.

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PRELIMINARY STATEMENT.

The five questions presented by petitioners suggest a failure to understand the theory of Count I of the complaint, a theory readily comprehended by the Court of Appeals and by the court held to be actionable under section 17(a) of the Securities Act of 1933, section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Commission (the "anti-fraud provisions of the securities laws"). A brief review of the facts will bring petitioners' failure into sharper focus.

THE FACTS.

Count I alleges a conspiracy between the directors of The Susquehanna Corporation ("Susquehanna") and Herbert Korholz, all of whom are parties defendant, to defraud Susquehanna by causing it to purchase indirectly from its directors (the "Lannan group") 435,000 shares of Susquehanna stock at a price of $6,525,000.00, a sum $1,740,000.00 greater than the fair market value of the shares. The scheme was to be accomplished in two related steps.

The first step was the sale of the 435,000 shares by the Lannan group to Korholz who acted on behalf of defendant, American Gypsum Co. ("Gypsum"), a corporation controlled by Korholz through his ownership of 56% of that corporation's stock. The Lannan group agreed to vest de facto control of Susquehanna in Korholz by seriatim resignations as Susquehanna directors, the remaining directors to fill such vacancies on the board, as they occurred, by the election thereto of Korholz and his nominees. The success of the conspiracy depended upon the reelection of the Lannan group as Susquehanna directors at the annual stockholders' meeting to be held April 19, 1965.

To perform their part of the bargain, the Lannan group in March and April 1965, made written and oral solicitations of proxies pledged to their reelection as Susquehanna directors. These proxy solicitations contained misrepresentations of fact all of which were pleaded with particularity. The Lannan group was successful in electing thirteen out of fifteen members to the board. Within a month four members of the Lannan group resigned as directors. The remaining directors then elected Korholz chairman of the board and three of his nominees, impleaded as defendants, filled the other vacancies.

With control of both Susquehanna and Gypsum vested in Korholz, the second step in the conspiracy—the sale to

Susquehanna of the Lannan group's 435,000 shares of Susquehanna—could be realized through the device of a merger of Gypsum into Susquehanna. By issuing its shares for the outstanding shares of Gypsum, Susquehanna would acquire all of Gypsum's assets, including the 435,000 shares of Susquehanna acquired from the Lannan group. For these 435,000 shares Susquehanna would be obliged to pay in new shares the equivalent of $6,525,000.00 which included the premium of $1,740,000.00 wrongfully received by the Lannan group.

In May 1965, a dissident group of Susquehanna stockholders ("the Kansas City group") threatened a stockholder's suit against the defendants attacking the Lannan group's sale of the 435,000 shares of Susquehanna. To silence the Kansas City group, and to keep in darkness the Lannan group-Korholz conspiracy, the defendants caused Susquehanna to exchange 140,000 shares of Vanadium Corp. of America ("Vanadium") for 222,107 shares of Susquehanna, plus $300,685.00 in cash. The basis on which this exchange of stock was effected undervalued the Vanadium shares by $700,000.00, the profit realized by the Kansas City group a few days later on the sale of the 140,000 shares of Vanadium to the Vanadium Corp. of America.

By virtue of his control over the boards of directors of both Susquehanna and Gypsum, Korholz secured the passage of resolutions by the directors of both corporations recommending the merger of Gypsum into Susquehanna. On October 22, 1965, before the matter was submitted to the stockholders of either corporation, respondents filed Count I of the complaint, seeking to recover for Susquehanna the premium of $1,740,000.00 received by the Lannan group on the sale of the 435,000 shares of Susquehanna stock, the $700,000.00 lost to Susquehanna on the Vanadium transaction and asking that the proposed Susquehanna-Gypsum merger be enjoined.

The facts are not in dispute. The Lannan group's sale of the 435,000 shares of Susquehanna, the misrepresentations in the March and April 1965 proxy statements and the sale of the Vanadium stock were all alleged to be defendants' overt acts in furtherance of the conspiracy. By their motions to dismiss for failure to state a claim, petitioners admitted the truth of these allegations.

QUESTIONS PRESENTED.

The first question presented by petitioners (Pet. p. 2) is not compatible with Rule 23(c) of this court in that it is not expressed in the terms and circumstances of the case. As stated it calls for an answer without regard to the facts alleged in Count I. Respondents would restate the question presented as follows:

> May a corporation, induced by fraud to issue its stock in exchange for the stock of another corporation pursuant to a statutory merger, be a seller or purchaser of securities within the ambit of the anti-fraud provisions of the securities laws?

The second question presented by petitioners (Pet. p. 2) ignores the thrust of Count I, that the injured party was Susquehanna, not plaintiffs in their capacities as stockholders of the corporation; that the cause of action belongs to Susquehanna and was asserted by plaintiffs derivatively on behalf of Susquehanna. The second part deals with the sufficiency of the statement of the claim and does not fall within the purview of Rule 19 of this court.

The third question presented by petitioners (Pet. p. 3) ignores the conspiratorial framework of Count I and treats each allegation as an isolated transaction unrelated to the other overt acts alleged to be a part of the conspiracy.

The fourth question presented (Pet. p. 3) deals with the sufficiency of the statement of the claim and does not fall within the purview of Rule 19 of this court.

The fifth question presented (Pet. p. 3) is not compatible with Rule 23(c) of this court in that it is not expressed in the terms and circumstances of the case in the following respects:

(a) Plaintiffs did not sue as shareholders of a constituent corporation in a consummated merger.

(b) The proxy soliciting material about which complaint is made in Count I was not filed with the Commission.

Respondents submit that of the five questions presented by petitioners, only the first, as modified herein, is in accord with Rule 23(c) of this court.

REASONS FOR DENYING THE WRIT.

In the case at bar the Court of Appeals decided that a constituent corporation in a statutory merger (as distinguished from a shareholder of such corporation) induced by fraud to exchange its stock for stock of the other constituent corporation, was a seller of securities entitled to the protection of the anti-fraud provisions of the securities laws. The rule in *Dasho* is narrower than the federal question petitioners ask this court to settle. In view of the unanimity among the federal courts which have passed upon the issue in *Dasho,* the federal law is settled. While *Dasho* decided the issue for the first time at the appellate level, the right of a constituent corporation in a statutory merger to the protection of the securities laws has been upheld in *H. L. Green Company, Inc.* v. *Childree,* 185 F. Supp. 95, 96 (S. D. N. Y. 1960) and in *Simon* v. *New Haven Board & Carton Company,* 250 F. Supp. 297, 298, 299 (D. Conn. 1966), the only other cases in which the issue has been before the courts.

Dasho, H. L. Green and *Simon* are structured on the broad base of *Hooper* v. *Mountain States Securities Cor-*

poration, 282 F. 2d 195, 203 (5 Cir. 1960); *Ruckle* v. *Roto American Corporation,* 339 F. 2d 24, 27 (2 Cir. 1964); *Kane* v. *Central American Mining & Oil, Inc.,* 235 F. Supp. 559, 564 (S. D. N. Y. 1964) and others, which hold that a corporation induced by fraud to issue its stock in exchange for inadequate consideration is a defrauded seller under the federal securities laws.

Petitioners would distinguish a statutory merger from all other transactions in which a corporation exchanges its shares for shares of another corporation. Remedial statutes, as are the securities laws, are not to be emasculated by putting form above substance.

That the complexities of corporate mergers afford fertile ground for fraud need not be demonstrated by argument, or example. If a statutory merger is to be exempted from the anti-fraud provisions of the securities laws, there should be a compelling reason. No such reason appears in the adjudicated cases and such exemption is inconsistent with the broad purposes of the legislation—to protect investors and to keep the instrumentalities of interstate commerce and security exchanges free of fraud in security transactions.

It is the position of the Commission today, as disclosed by its brief *amicus* in *Dasho,* that the issuance of stock by a corporation, in exchange for stock of another corporation pursuant to a statutory merger, is a sale and purchase of securities under the anti-fraud provisions of the securities laws.

Petitioners (Pet. pp. 12-14) say the "no sale" theory (now codified in Commission Rule 133 promulgated under the Securities Act of 1933) is in conflict with the decision in *National Supply Co.* v. *Leland Stanford, Jr. University,* 134 F. 2d 689 (9 Cir. 1943). This is not the case. *National Supply Co.* was decided on the ground of laches, not upon

any principle germane to the issue before this court. Furthermore, by its express terms the rule applies only to section 5 of the Securities Act of 1933 governing the registration of securities. It has no application to the Securities Exchange Act of 1934, or in fact, to the fraud provisions of the Securities Act of 1933. This was made clear by the Commission at the time it promulgated Rule 133, saying in Commission Release No. 3420, August 2, 1951:

> "The new rule is specifically limited by its terms to Section 5 of the Securities Act. Consequently, whether or not a sale is involved for any other purpose will depend upon the statutory context, and the question should in no sense be influenced by the rule. As a matter of statutory construction, the Commission does not deem the 'no-sale theory' which is described in the rule as being applicable for purposes of any of the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934."

Petitioners argue (Pet. pp. 14, 15) that the Court of Appeals, in considering the Lannan group's sale to Korholz of 435,000 shares of Susquehanna as actionable, was at variance with the rule in *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (2 Cir. 1952), since neither Susquehanna nor plaintiffs were parties to the sale. There is, however, no variance because *Birnbaum* does not apply. Count I alleges a conspiracy to sell the 435,000 shares to Susquehanna. The sale of the shares to Korholz acting for Gypsum was alleged as the first overt act of the conspiracy to sell the shares to Susquehanna. Korholz and Gypsum were conduits only. Under the theory of Count I, Susquehanna was the intended purchaser. Until the merger with Gypsum was consummated, the sale to Susquehanna of the 435,000 shares was executory, but this is of no moment since the securities laws extend to executory as well as executed sales of securities. Sec. 2(3) Securities Act

of 1933; Sec. 3(a) (13) (14) Securities Exchange Act of 1934.

The related federal question referred to by petitioners (Pet. pp. 15, 16) disappears upon a reading of Count I. Count I, of course, "made no allegation of any fraudulent misrepresentation or omission in the Proxy Statement relating to the merger, as filed with the Commission under Section 14(a) of the Exchange Act and circulated to the stockholders of Susquehanna and Gypsum" because the proxy statement petitioners refer to was issued three weeks after Count I was filed. Count I complained of misrepresentations in the proxy statements issued in March and April 1965, and those misrepresentations were pleaded with particularity. Respondents would point out that at the time the March and April 1965 proxy statements were issued, Section 14(a) of the Securities Exchange Act of 1934, governing the solicitation of proxies, did not apply to corporations, such as Susquehanna, which traded their stocks over-the-counter. The misrepresentations in the March and April 1965 proxy statements were, therefore, actionable only under the anti-fraud provisions of the securities laws.

CONCLUSION.

For the foregoing reasons, the petition for writ of certiorari should be denied.

Respectfully submitted,

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SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
NOV 21 1967
JOHN F. DAVIS, CLERK

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v.

WILLIAM DASHO, DASHO-ROGERS, INC., an Illinois corporation, and MAURICE H. SCHY, *Respondents.*

PETITIONERS' BRIEF IN REPLY TO RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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PETITIONERS' BRIEF IN REPLY TO RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

PRELIMINARY STATEMENT

The substantive reasons advanced by Respondents for the denial of the Petition in this case are related only to the first of the Questions Presented in the Petition. The remaining Questions are challenged as not in accord with Rule 23-1(c). Although we shall later advert briefly to that challenge, this reply brief will primarily concern itself with Respondents' comments on the status of federal law bearing on the first Question.

The first Question, as set forth in the Petition (Pet. 2), is whether, as a matter of interpretation of the federal

securities laws, a statutory merger involves a sale by the merged corporation or a purchase by the surviving corporation, and, if so, whether the complaint states a cause of action under those laws.* Respondents (R. Br. 4) argue that this statement of the Question is not expressed in the "terms and circumstances of the case". In thus challenging the Question, Respondents ignore the thrust of the opinion of Judge Fairchild below. His opinion, written also on behalf of Judge Cummings, raised the question whether a statutory merger involves the "sale of the shares or assets of merging corporations" (App. A-10), and concluded that Susquehanna, the surviving corporation, had a cause of action with respect to the "acquisition, by merger", from Gypsum, the merged corporation, of 435,000 Susquehanna shares (App. A-14). Respondents' "restated" question includes the cognate issue which, consistently with Rule 23-1(c), is fairly comprised within Petitioners' first Question and was fully discussed in the Petition (Pet. 9-12), as to whether the surviving corporation in a statutory merger is a "seller" of securities, as well as the related issue whether that corporation is a "purchaser" of securities. Respondents argue, erroneously, that the federal law on both of these issues is "settled". Furthermore, they predicate their "restated" question on the assumption that the allegations of the complaint support the conclusion that, as a matter of federal securities law, fraud was perpetrated on Susquehanna in connection with its assumed "sale" and "purchase" of securities in the merger.

We respectfully submit that the Respondents' brief fails to show that the federal law on any of these issues is "settled".

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* "Pet." refers to the Petition; "App." to the Appendix to the Petition; "R." to the appendix record on appeal lodged with the Clerk of the Court; "R. Br." to Respondents' Brief in Opposition; "Susquehanna" to The Susquehanna Corporation; and "Gypsum" to American Gypsum Co.

STATUS OF FEDERAL LAW ON ISSUES IN "RESTATEMENT" OF FIRST QUESTION PRESENTED

As to Whether, for the Purpose of the Federal Securities Laws, the Surviving Corporation in a Statutory Merger Effects a "Sale" or a "Purchase" of Securities.

In support of their position as to the "settled" status of federal law on the issue of "sale", Respondents cite only *H. L. Green Company, Inc.* v. *Childree,* 185 F. Supp. 95 (S.D. N.Y. 1960) and *Simon* v. *New Haven Board & Carton Company,* 250 F. Supp. 297 (D. Conn. 1966). The *H. L. Green Company, Inc.* case did not involve a statutory merger, but an exchange by the issuing corporation, in an individual transaction, of its stock for stock of another corporation. See *H. L. Green Company, Inc.* v. *MacMahon,* 312 F. 2d 650 (2 Cir. 1962), cert. den. 372 U.S. 928 (1943).

As stated by the court in the 1960 *H. L. Green Company, Inc.,* decision: "[M]erger is not a term of fixed and definite content. A transaction properly so described may or may not involve a purchase and sale within the meaning of Section 10(b) of the Act."* The remaining single decision of the district court in the *Simon* case to the effect that the surviving corporation in what may have been a statutory merger was a "seller" of securities, clearly does not "settle" federal law on this issue.

The Respondents say that the *H. L. Green Company, Inc.* decision, the *Simon* decision and the decision of the court below are "structured on" *Hooper* v. *Mountain States Securities Corporation,* 282 F. 2d 195 (5 Cir. 1960), *Ruckle* v. *Roto American Corporation,* 339 F. 2d 24 (2 Cir. 1964) and *Kane* v. *Central American Mining & Oil, Inc.,* 235 F. Supp. 559 (S.D. N.Y. 1964). It is true that each of these cases held that a corporate issuer of stock to a third party, in an individual transaction, was a "seller" of stock, for

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* 185 F. Supp. 95, 96.

the purpose of Section 10(b) of the Exchange Act and Rule 10b-5 of the Securities and Exchange Commission (the "Commission"). But none of these cases involved a statutory merger, and they clearly do not constitute any determination with respect to the legal issue whether, for the purpose of the federal securities laws, the surviving corporation in a statutory merger is a "seller" of securities.

Furthermore, since neither *Hooper, Ruckle, Kane,* nor *H. L. Green Company, Inc.* involved a statutory merger or consolidation, they are clearly not determinative on the further issue whether such a transaction involves a "purchase" of securities by the surviving company. And no such issue was considered in connection with the transaction before the court in the *Simon* case, *supra,* the only other case relied upon by Respondents as "settling" federal law.

Respondents urge (R. Br. 6-7) that *National Supply Co.* v. *Leland Stanford Jr. University,* 134 F. 2d 689 (9 Cir. 1943), cert. den. 320 U.S. 773 (1943), discussed in the Petition (Pet. 10-12), is not germane to the issues here involved, and that the Commission's narrow application, adopted by the court below, of the "no-sale" theory expressed in Rule 133 as to statutory mergers (17 C.F.R. § 230.133 (1967)), is not in conflict with that decision. This is simply not so. It is true that, in reversing the District Court's decision in favor of a stockholder who challenged a statutory consolidation, the Court of Appeals found laches. However, after pointing out that the findings of the District Court had indicated "the belief that appellee has causes of action under both § 12(1) and § 12(2) of the [Securities] Act",* the court also expressed unequivocally its concurrence with the views of the Commission in its "exhaustive brief amicus curiae", to the effect that the "civil liability provisions of the Act have no application".**

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* Section 12 (15 U.S.C. § 77*l*), as then in effect, is set forth in the Appendix to this brief.

** 134 F. 2d 689, 694.

In summarizing the three civil liability provisions of the Act, the Commission had pointed out that two were relevant, i.e., clause (1) of Section 12, imposing liability upon a person who "sells" unregistered securities, and clause (2) of that section, imposing liability upon a person who "sells" securities by means of misrepresentations or material omissions of fact.* Referring to the causes of action asserted by the plaintiff under each clause, the Commission pointed out that "if there is no 'sale' under the statutory definition, there can be no cause of action under either Section 12(1) or Section 12(2)," and concluded that in a statutory consolidation or merger no sale occurs. The Commission's subsequent interpretation of the Act implicit in Rule 133 and related releases, to the effect that, despite identical pertinent text, a statutory consolidation or merger involves a "sale" of securities for the purpose of clause (1), but not for the purpose of clause (2), is in clear conflict with the Court's decision and the position of the Commission in the *National Supply Co.* case.

As to Whether the Allegations of the Complaint Support the Conclusion That, as a Matter of Federal Securities Law, Fraud Was Perpetrated on the Surviving Corporation in Connection With Its Assumed "Sale" or "Purchase" of Securities in a Statutory Merger.

The first Question, as "restated" by Respondents, is bottomed on the assumption that alleged deficiencies in proxy materials relating to Susquehanna's annual meeting, and certain statements made at that meeting, held in April, 1965, involved a "fraud" on the corporation within the meaning of Section 10(b) of the Exchange Act "in connection with" its "sale" and "purchase" of securities in the merger which occurred eight months later. This assumption is made despite the requisite vote of stockholders obtained on the basis of a subsequent proxy state-

* The third provision (Section 11; 15 U.S.C. § 77k) imposes civil liability only for registration-statement deficiencies.

ment relating to the merger which was held by the District Court to be fully informative,*—a conclusion not questioned by the Court of Appeals.

Alleged deficiencies in the proxy materials for the annual meeting, which was concerned only with the election of directors, constitute the crux of the "fraud" on which the action is based. The position of Petitioners is that since such deficiencies, if any, even if actionable under state law, involved matters of corporate management and were not made "in connection with the purchase or sale of securities",** they were not actionable under Section 10(b) of the Exchange Act.

The case at bar thus differs from *Ruckle* v. *Roto American Corporation,* 339 F.2d 24 (2 Cir. 1964), which was relied upon by the appellate court below. In that case, the court held that the failure or refusal of a majority of a board of directors of a corporation to disclose to the remaining directors material data relevant to the corporation's financial condition and to the consideration to be received by the corporation for stock to be issued by it, constituted a "fraud" on the corporation in connection with the "sale" of such stock, and hence gave rise to a cause of action in favor of the corporation under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Petitioners' view that *Ruckle* does not "settle" the law in the case at bar is supported by the subsequent but substantially concurrent decision of the same court in *O'Neill* v. *Maytag,* 339 F. 2d 764 (2 Cir. 1964), which the majority of the court below considered but refused to follow. There, despite the contrary views expressed by the Commission in its amicus curiae brief, the court held that no cause of action arose under Section 10(b) of the Exchange Act in favor of a corporation, where it was alleged that its directors approved the acquisition by the corporation of a sub-

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* App. 36-37; 52-53.

** Section 10(b) prohibits the use or employment of manipulative or deceptive devices *"in connection with the purchase or sale"* of securities involving the requisite jurisdictional facilities, in contravention of rules promulgated by the Commission (15 U.S.C. § 78j(b)). [Emphasis supplied]

stantial block of its shares at an excessive price, in order to eliminate the threat to their control posed by the continuing concentrated ownership of such shares. The court distinguished *Ruckle* on the ground that in that case there had been a "clear allegation of deception in connection with the sale of securities",* whereas in the case then before it the question was whether the duty allegedly breached was "only the general duty existing among corporate officers, directors and shareholders".** The court pointed out, as it had previously stated in *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461, 464 (2 Cir. 1952), cert den. 343 U.S. 956 (1952), that Section 10(b) and Rule 10b-5 were "directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs." Although it recognized the difficulties which might be involved in drawing this line, the court held that such difficulties do not justify "treating the section or the rule as a mandate to inquire into every allegation of breach of fiduciary duty respecting the issuance or sale of corporate securities". *** The nature of the problem posed by *Ruckle*, *Maytag* and the case at bar has been well stated by Arthur Fleischer, Jr., former Executive Assistant to the Chairman of the Commission:

> "In sum, the implications of *Maytag* and, to some extent, *Ruckle* are unclear. On one hand, they may be taken to stand for the proposition that the only form of deceit that will sustain an action under the securities acts is that which affects the financial judgment of an investor. But on the other, the cases may stand for the proposition that an allegation of less than complete disclosure with regard to any aspect of any securities transaction will support a federal claim. "If the second reading should prove to be correct, it

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* 339 F. 2d 764, 768.
** 339 F. 2d 764, 767-768.
*** 339 F. 2d 764, 768.

would involve the federal courts in working out federal rules to govern every aspect of corporate behavior that involves securities. This would be unfortunate.'"*

The "second reading", posed by Mr. Fleischer, of the implications of *Maytag* and *Ruckle* is assumed by Respondents in their "restatement" of the first of the Questions Presented in the Petition.** The adoption of any such reading would involve the resolution of a major unsettled issue of interpretation and application of the federal securities laws which merits the consideration of this Court.

REPLY TO RESPONDENTS' OBJECTIONS TO OTHER QUESTIONS PRESENTED

Having considered Respondents' comments on the status of federal law with respect to the first Question, we shall now comment briefly on their challenge of the remaining Questions as not in accord with Rule 23-1(c).

The second Question (Pet. 2) was whether Respondents, as shareholders of Susquehanna, were, within the federal securities laws, purchasers of securities, despite no change in share-ownership. The question was so framed, since the complaint (Para. 1, R. 5) alleged that the action was brought not only on behalf of Susquehanna but on behalf of the

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* Fleischer, "'Federal Corporation Law': An Assessment," 78 Harv. L. Rev. 1146, 1166.

** In its opinion of June 28, 1966, the District Court, referring to its earlier opinion of April 15, 1966, considered and rejected such a "second reading", stating (R. 52-53):

> "In that decision, we held that the only possible sale in issue, if one was present at all, took place at the time of merger, and accordingly directed our attention solely to misstatements or omissions which may have directly influenced consummation of that act. * * * * We are not concerned with the election of directors, but only with the material facts going to the approval of the merger itself."

We regret that the District Court's second opinion, reported at 267 F. Supp. 513, was erroneously referred to at page 2 of our Petition as appearing at page 39, rather than page 46, of the appendix record on appeal.

plaintiffs and all other shareholders similarly situated. Since the Respondents now recognize that the action is solely a derivative action on behalf of Susquehanna and does not involve the issue whether the plaintiffs themselves were purchasers of securities, the second Question need not be considered.

As to the third and fourth Questions (Pet. 3), Petitioners submit that, in considering whether, as Respondents allege, the merger of Gypsum into Susquehanna was the culmination of a conspiracy in violation of the federal securities laws, it would be relevant for this Court on review to consider whether two "overt acts" alleged to be essential parts of the conspiracy were themselves in violation of any such laws. Respondents' further challenge of the fourth Question, as not within Rule 19 of the Court, erroneously confuses the considerations governing the exercise of the Court's discretion in granting certiorari, as stated in Rule 19, with the requirements of Rule 23-1(c) as to the statement of questions presented for review.

Respondents' challenge of the fifth Question (Pet. 3) as not "expressed in the terms and circumstances" of the case, is unwarranted. It presumably stems from the fact that, as stated in the amendment to the complaint filed on November 12, 1965, the merger at that date had not yet been consummated and the proxy-soliciting material relating to the proposed merger, although then on file with the Commission, had not yet been sent out (Para. 26, R. 20).

However, both the District Court and the Court of Appeals recognized, as the record* shows, that at the time of the District Court's first decision, on April 15, 1966, such proxy-soliciting material had gone out and the merger had been consummated. The related proxy-soliciting material, as to which there was no "factual question" (R. 53), which

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* The District Court stated in its first opinion: "Plaintiffs were fully informed of the details of which they complain before the merger was consummated * * * and were free to invoke their rights of appraisal at the time of the merger". (R. 37).

was found by the District Court to provide full disclosure (R. 35-37; 52-53), was filed by Respondents in the Court of Appeals, and is a part of the record lodged with this Court.

CONCLUSION

Respondents have failed to set forth sufficient grounds for denying the Petition. If the Petition is granted, Petitioners, for reasons given in this reply brief, would deem it appropriate to eliminate the second Question presented by the Petition.

Respectfully submitted,

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November 21, 1967

APPENDIX

SECTION 12 of Securities Act of 1933 (15 U.S.C. § 77*l*), as in effect prior to August 10, 1954:

§ 77*l*. Civil liabilities arising in connection with prospectuses and communications.

Any person who—

(1) sells a security in violation of section 77e of this title, or

(2) sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Note: This Section was amended in 1954 by the insertion of the words "offers or" before the word "sells" in clauses (1) and (2).